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Tom Hagy
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Editorial Office

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Articles and Submissions

Direct editorial inquiries and send material for publication to:

Tom Hagy, Editor-in-Chief, tom.hagy@litigationconferences.com

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Morgan Morrissette Wright, Publisher, Full Court Press at mwright@fastcase.com or at 202.999.4878

For questions or Sales and Customer Service:

Customer Service
Available 8am–8pm Eastern Time
866.773.2782 (phone)
support@fastcase.com (email)

Sales
202.999.4777 (phone)
sales@fastcase.com (email)

Clearing the Haze: State Laws and Private Plaintiffs Critical to Preserve Competition in Cannabis

Ausra O. Deluard and Jennifer M. Oliver*

Abstract: *Legalized cannabis is an exciting and blossoming industry, but regulations are nascent and compliance is complicated and costly. Licensed operators face numerous challenges that black- and gray-market competitors avoid, thus increasing their competitive advantage to the detriment of legitimate cannabis operators. And that is where, through strategic use of unfair competition laws, private plaintiffs can play a key role. This article explores the panoply of competition issues in the exploding cannabis industry, including cases already filed and the challenges we expect to see in the future.*

You have heard the cliches: legalized cannabis is the Wild West, a new frontier, a modern-day gold rush. It is an exciting and blossoming industry, to be sure, but regulations are nascent and compliance is both complex and costly.

Licensed operators face numerous challenges. Here are just a few: onerous federal tax interpretations that prevent expense deductions, state and city taxes and licensing fees, lack of banking options and the ability to use credit card networks, strict regulations that limit advertising and marketing efforts, stringent testing standards to prevent the use of harmful pesticides and other chemicals, and evolving rules and interpretations.

Black- and gray-market competitors avoid many of these challenges, thus increasing their competitive advantage to the detriment of legitimate cannabis operators. As the State of California's Cannabis Advisory Committee has reported, "fragmented and uncoordinated" enforcement has allowed the black market to flourish, "threatening licensed business with unfair competition."[1] But, state and local enforcement is hampered by a lack of resources. And that is where private plaintiffs can play a key role.

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Questions Around Federal Enforcement, For Now

We begin with a threshold question many observers of the exploding cannabis market have pondered: Do federal antitrust laws apply to an industry that is legal in many states, but not under federal law? Because cannabis remains prohibited under the federal Controlled Substances Act (CSA), its legal manufacture and distribution is limited to intrastate activities. While some cannabis companies have presences in several states, often referred to as "multi-state operators" or "MSOs," cannabis product cannot cross state lines. Does this mean that consumers of cannabis products may be less protected from inflated prices caused by anticompetitive conduct, such as abuse of category captain arrangements[2] or agreements to fix prices or allocate markets?

The Supreme Court has broadly interpreted activities that occur entirely intrastate to nonetheless affect interstate commerce. In *Wickard v. Filburn*, the Court expansively read the Commerce Clause to apply to a farmer's personal cultivation and consumption of wheat because it "exert[ed] a substantial economic effect on interstate commerce."[3] The farmer had argued that his intrastate, and unsold, cultivation should not be regulated as interstate commerce described in the Constitution as "Commerce . . . among the several states."[4] The Court decided that his personal cultivation reduced the amount of wheat he would buy for animal feed on the open market, which is traded nationally and thus interstate. The Court also considered that rising market prices of wheat could draw such wheat into the interstate market, resulting in lower market prices. Decades later, the Supreme Court applied *Wickard v. Filburn* to hold that the CSA applied to personal cultivation of cannabis for medical use. In *Gonzales v. Raich*, the Court explained that the high demand in the interstate market would draw such homegrown cannabis into that market, holding "the regulation is squarely within Congress' commerce power because the production of the commodity meant for home consumption, be it wheat or marijuana, has a substantial effect on supply and demand in the national market for that commodity."[5]

In considering the scope of the federal antitrust laws specifically, the Supreme Court examined the commerce requirements of the Clayton and Robinson-Patman Acts in *Moore v. Mead's Fine Bread Company*.[6] The opinion discussed in *dicta* that while the victim is a local merchant, and no interstate transactions were used to

destroy him, the beneficiary is an interstate business, the treasury used to finance the pricing warfare is drawn from interstate, and the prices on interstate sales were kept high while the local prices were lowered.[7]

> If this method of competition were approved, the pattern for growth of monopoly would be simple. As long as the price warfare was strictly intrastate, interstate business could grow and expand with impunity at the expense of local merchants. The competitive advantage would then be with the interstate combines, not by reason of their skills or efficiency but because of their strength and ability to wage price wars. The profits made in interstate activities would underwrite the losses of local price-cutting campaigns.[8]

But the Supreme Court later departed from this discussion in *Gulf Oil v. Copp Paving* and distinguished the reach of the Sherman Act from the Robinson-Patman and Clayton Acts.[9] The Sherman Act[10] prohibits conduct "in restraint of trade or commerce" so its commerce requirement can be met by wholly intrastate conduct if it substantially affects interstate commerce.[11] In contrast, the Robinson-Patman and Clayton Acts forbid certain acts by persons engaged "in commerce."[12] The Supreme Court explained that this distinct "in commerce" language "appears to denote only persons or activities within the flow of interstate commerce—the practical, economic continuity in the generation of goods or services for interstate markets and their transport and distribution to the consumer."[13] Section 7 of the Clayton Act, which prohibits acquisitions that may substantially lessen competition, was subsequently expanded in 1980 to apply to persons engaged "in any activity affecting commerce."[14]

Indeed, the Department of Justice took advantage of the expanded scope of Section 7 to investigate a series of cannabis mergers in 2019.[15] The series of cannabis second requests issued by the Department of Justice in 2019 signaled that the federal government can, and will, enforce antitrust laws in the cannabis industry, even if cannabis remains a Schedule I drug.

While federal antitrust claims should prove to be one important tool to ensure a level playing field, there are attributes of the cannabis industry structure that could prove challenging for plaintiffs under federal antitrust jurisprudence, *e.g.*, pleading traditional

relevant market definitions or market power where the regulatory landscape is complex and changing. For these reasons and others, cannabis could spur a renaissance in state unfair competition law.

California Cannabis Looms Large

California, the largest state to legalize recreational marijuana, is also home to one of the country's most robust and comprehensive unfair competition laws, also known as the "UCL," or California Business and Professions Code §§ 17200 *et. seq.* A vast web of local ordinances and zoning restrictions governing California's cannabis industry offers plaintiffs numerous bases upon which to bring such claims against violating competitors and market participants. The UCL covers "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising."[16]

Plaintiffs also have California's False Advertising Law (FAL) and the California Legal Remedies Act (CLRA) at their disposal. The FAL broadly prohibits the advertising of goods or services using "any statement … which is untrue or misleading, and which is known, or which … should be known, to be untrue or misleading."[17] California cannabis regulations similarly prohibit such marketing, including specifically with regard to health statements.[18] The CLRA, on the other hand, prohibits "unfair or deceptive acts or practices" connected with the sale of goods or services.[19] Violations include false advertising of goods, false or misleading statements regarding "price reductions," and misrepresenting the nature of a transaction.[20]

To establish standing under any of these statutes, a plaintiff must demonstrate that they have "suffered injury in fact and … lost money or property" because of the defendant's unlawful act, though courts note that "injury in fact is not a substantial or insurmountable hurdle."[21] While private actions under the UCL and FAL are limited to restitution and injunctive relief, the CLRA expressly states compensatory and punitive damages are available.

Finally, the state's licensing law, the Medicinal and Adult Use Cannabis Regulation and Safety Act (MAUCRSA) forbids geographic price discrimination for the purpose of injuring competitors or competition, price fixing, collusion, and predatory pricing behavior.[22] A licensee shall not sell any cannabis or cannabis products below cost for the purpose of injuring competitors or

misleading purchasers or give away any article or product for the purpose of injuring competitors or destroying competition.[23] And the pièce de résistance? Private plaintiffs can sue under MAUCRSA itself to recover monetary damages, relief not available under the UCL or FAL.[24]

Case law has not yet developed under B.P.C. § 26052 to define the elements of these violations, leaving room for a more expansive reading that may favor disadvantaged competitors. Could cost be interpreted to include cost of compliance, effectively making gray-market competitors (who are licensed but not compliant) liable and providing law-abiding licensees an opportunity to level the playing field? If private enforcement proves effective, perhaps the California Legislature would expand the law to capture black-market competitors. As industry association commentators have noted, "the California Legislature has shown its willingness to author bills that will strengthen the regulated market while minimizing the illicit market."[25]

In cannabis, perhaps the most common claims under these laws to date have been consumer class actions alleging misleading labeling with regard to the concentration of CBD in a particular product. For example, in *Glass v. Global Widget LLC*,[26] the class representative plaintiff alleged defendant's CBD products were labeled with incorrect dosage information and that he would not have purchased the products had he known they were not yet regulated.[27] In *Cynthia Davis v. Redwood Wellness, LLC*,[28] the plaintiff alleged the defendant systematically and prominently mislabeled its products, forming a pattern of unlawful and unfair business practices that harmed the public.

Cases complaining of false or misleading advertising regarding particular "strains" of plants or unsubstantiated health claims are also likely to proliferate. In *Colette et al. v. CV Sciences, Inc.*,[29] the plaintiffs alleged defendants' products were mislabeled as dietary supplements or contained "the illegal dietary ingredient CBD." Their complaint alleges several counts of state law violations, including false advertising and unfair competition laws, as well as California's Sherman Food, Drug, and Cosmetic Law, which adopts federal labeling regulations as the state's food labeling requirements.[30]

With the availability of the UCL, FAL, CLRA, and MAUCRSA, California will likely remain at the forefront of private competition claims in cannabis. But other states have plenty to offer competitors as well.

Other Trailblazers in Cannabis: From the White City to the Highest State

Heading east from the Pacific to the Great Lakes, Illinois private plaintiffs can pursue relief from unfair competition and deceptive trade practices through the Uniform Deceptive Trade Practices Act (UDTPA).[31] UDTPA prohibits false and fraudulent advertisements and allows plaintiffs to bring a private cause of action against anyone who, among other things, "passes off goods or services as those of another"; "causes likelihood of misunderstanding as to the source or certification of goods or services" or "as to affiliation with or certification by another"; "uses deceptive representations of the geographic origins of goods or services"; "represents that goods or services are of a particular quality, if they are of another"; "disparages the goods, services, or business of another by false or misleading representations"; "advertises goods or services with intent not to sell them as advertised, or in supply expected to meet public demand without disclosing a limitation of quantity"; or "makes false or misleading statements concerning price reduction." All are behaviors that are evident in the cannabis industry.

The UDTPA allows plaintiffs to seek injunctive relief and costs, but not actual damages. However, competitors who have incurred monetary damages may assert those claims alongside additional fraud-related claims under the Illinois Consumer Fraud and Deceptive Practices Act (ICFDPA). The ICFDPA allows plaintiffs to seek damages for fraud, deception, false pretense, false promise, misrepresentation, or concealment of facts, where (1) the defendant has committed a deceptive act or practice, (2) the defendant intended the plaintiff to rely on the deception in the course of trade or commerce, and (3) the fraud caused actual damages to the plaintiff.[32]

Like California, Illinois' cannabis legislation also provides certain safeguards against anticompetitive practices. Illinois' Cannabis Regulation and Tax Act limits dispensaries from sourcing more than 40 percent of their product from one cultivator to prevent cultivators from entering into exclusive agreements and dispensaries from stockpiling supply from a single source.[33] In January 2020, Illinois regulators notified dispensaries that they were investigating apparent violations of the rule after dispensaries complained to the Illinois Attorney General's office.[34] As dispensaries statewide struggled with supply shortages, some were worried that vertically

integrated operators could be trying to control the market by foreclosing competing dispensaries from supply.

Colorado, one of the first two states to legalize recreational marijuana, has outlined what qualifies as deceptive and unfair trade practices under the Colorado Consumer Protection Act, (CCPA).[35] Notably, Colorado's definition of deceptive and unfair trade practices is relatively broad and provides specific non-exhaustive examples, including where a party "knowingly represents that hemp, hemp oil, or any derivative of a hemp plant constitutes retail marijuana or medical marijuana unless it fully satisfies the definition of such products pursuant to Colorado statutes."[36]

But would-be plaintiffs face at least one significant hurdle in the "Highest State": its supreme court has held that unfair or deceptive trade practice claims made under the CCPA must be intentional in order to establish liability; negligent actions do not amount to unfair or deceptive trade practices under the act.[37] Proving intent may be difficult, especially where black- and gray-market players may not have document preservation policies or use traditional modes of business communication such as email. However, common law unfair competition claims are also available.[38]

Plaintiffs in Medical-Only States Find Recourse as Well

Of course, many large states have not yet legalized recreational cannabis. New York and Florida are prime examples. Under section 349 of New York's General Business law, "deceptive acts or practices in the conduct of any business, trade or commerce or in the furnishing of any service in this state are . . . declared unlawful." Likewise, "[t]he essence of an unfair competition claim under New York's common law is that the defendant assembled a product or provides a service which bears a striking resemblance to the plaintiff's product or service that the public will be confused as to the identity of the products. It is rooted in the bad faith misappropriation of the labors and expenditures of another, likely to cause confusion or to deceive purchasers as to the origin of the goods or services."[39] New York's unfair competition law offers existing medical dispensaries, and the recreational dispensaries that may open in the future, with a strong tool to combat misuse of trade secrets, trademarks and trade names, and false labeling or advertising.[40]

In Florida, claims for unfair business practices can be prosecuted under the Florida Deceptive and Unfair Trade Practices Act (also known as FDUTPA), which protects both consumers and businesses.[41] Like New York's statute, FDUTPA prohibits businesses from engaging in false advertising that would tend to deceive, confuse, or mislead a customer.[42] Although the statute is primarily intended to protect consumers, businesses also have standing to bring FDUTPA claims when they have been deceived by other businesses. Importantly, FDUTPA also provides for an award of attorney's fees to the prevailing party.

Competitor Litigation Outside the UCLs

While UCLs are an excellent tool to preserve competition, resourceful plaintiffs utilize a panoply of other claims and strategies as well. In New Jersey, for instance, we have officially seen the day when a cannabis dealer asks for *more* government oversight. In *Terrapin Investment Fund II v. Planning Board of the City of Hoboken et al.*, Terrapin, a medical marijuana dispensary company awaiting the planning board's approval to open, sued the Hoboken city planning board and a rival company over the city's cannabis licensing approval process.[43] Terrapin claims the defendant, who has already been approved to open a shop in the city, evaded newly established municipal laws requiring applicants to appear before a marijuana review board and provide more details about how their business will function. If both dispensaries ultimately open, they will be about one block apart.

In California, *Richmond Compassionate Care Collective (RCCC) v. 7 Stars Holistic Foundation et al.*[44] was filed after the first medical marijuana collective permit issued under the City of Richmond's Marijuana Ordinance was to RCCC's dispensary. Later, when the ordinance was amended to reduce the number of dispensary permits, RCCC lost its permit. RCCC sued under the Cartwright Act, California's state antitrust law, claiming its competitors worked together to generate community opposition to RCCC's applications being considered by the Richmond City Council. A group of the competitor defendants then filed a special motion to strike certain allegations of RCCC's suit, which was granted by the court on the grounds that the complaint was attacking protected free speech activity; that is, efforts to mobilize public opposition and efforts to

voice that opposition with City Council. However, the judge preserved RCCC's claims that its competitors conspired to purchase and tie up code-complaint properties and to fix prices, which are not activities protected by California provisions protecting free speech. In so ruling, the court noted that while it is possible that the defendants' activities might be protected, they failed to show how, and much of the alleged conduct was "incidental" to RCCC's antitrust claims.

Meanwhile, several "limited license" states are facing challenges related to license awards, including allegations that potential competitors unfairly manipulated the process. In Illinois, Southshore Restore and Heartland Greens, joined by an additional 19 unsuccessful applicants, filed suit against the state licensing department alleging certain successful applicants abused the process as "politically connected" insiders who may have unfairly had access to the "secret formula" scoring process.[45] And the State of Missouri has spent $1.3 million defending 853 license appeals from applicants who did not secure one of the 348 licenses awarded statewide.[46]

These are but a few examples of the wide range of claims that can ensue where regulations and licensing present substantial barriers, and evading or manipulating them creates an uneven playing field.

A Revolution With Ripple Effects?

Robust unfair competition laws are a means for companies to ensure the degree of profitability, viability, and success to which they are entitled in a fair and competitive market. And they may prove especially crucial in an industry haunted by black- and gray-market dealings.

Could the culture of the cannabis industry, with less risk-adverse and more proactive participants, spawn a broader revolution of licensed and compliant players taking a stand to protect competition? Could cannabis plaintiffs' strategic use of these laws have wide-reaching effects on courts' views of conduct in other industries? For example, if failure to abide by cannabis regulations constitutes unfair and deceptive trade practices, is a non-cannabis company more likely to face UCL liability for failure to abide by privacy or labor regulations?

Many questions remain, but we are inching closer to answers as the haze begins to clear.

Notes

* Ausra O. Deluard (ausra.deluard@dentons.com), of Dentons US LLP, has spent over a decade advising clients in a range of contentious and non-contentious antitrust matters, including merger investigations ("Second Requests"), competitor collaborations, and pricing and distribution policies. Since the passage of Prop. 64 in California, she has worked closely with cannabis clients to help them navigate the rapidly evolving cannabis laws and regulations throughout the United States. Ausra has been recognized as a Northern California Rising Star by Super Lawyers in Antitrust 2016-2019. She also teaches antitrust as an adjunct professor at U.C. Hastings.

Jennifer M. Oliver (joliver@moginrubin.com) is a partner at national antitrust boutique MoginRubin LLP, where she litigates and advises clients on competition issues. Her work includes representing classes of plaintiffs in class actions, risk mitigation and regulatory advice in mergers and acquisitions, and other complex business litigation. Jennifer is licensed to practice in New York, New Jersey, and California, is an IAPP Certified Information Privacy Professional (US), and was selected as one of the Daily Journal's Top 40 Under 40 Attorneys in the State of California for 2020.

1. "California's black market for pot is stifling legal sales. Now the governor wants to step up enforcement," *Los Angeles Times*, Feb. 18, 2019, available at https://www.latimes.com/politics/la-pol-ca-gavin-newsom-crackdown-pot-black-market-20190219-story.html.
2. Category management is a process for managing product categories on a store-by-store basis, and often involves collaboration between retailer and a single supplier who serves as the "category captain." Retailers sometimes delegate critical merchandising decisions to the "captain," and suppliers often pay for the honor of that role. This type of arrangement led to a $1.05 billion antitrust award in the tobacco industry in *United States Tobacco Co. v. Conwood Co.*, where the plaintiff alleged that the defendant unfairly dominated the smokeless tobacco industry through its category captain arrangement. In cannabis these are often referred to as "slotting" agreements.
3. 317 U.S. 111, 125 (1942).
4. Article I, Section 8: "The Congress shall have the Power To … regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."
5. *Gonzales v. Raich*, 545 U.S. 1, 19 (2005).
6. 348 U.S. 115 (1954).
7. *Id.* at 119.
8. *Id.*
9. 419 U.S. 186 (1974).
10. 15 U.S.C. § 1.
11. 419 U.S. 186, 194-195 (quoting *U.S. v. Women's Sportswear Mfrs. Assn.*, 336 U.S. 460 ("If it is interstate commerce that feels the pinch, it does not matter how local the operation which applies the squeeze.")).

12. 15 U.S.C. §§ 13(a), 14,15,18. Commerce is defined as "trade or commerce among the several States and with foreign nations." 15 U.S.C. § 12.

13. 419 U.S. 186, 195.

14. 1980-Pub. L. 96-349. The Hart-Scott-Rodino Act of 1976 ("HSR Act"), passed two years after *Copp Paving*, amended the Clayton Act to require companies to file premerger notifications with the Federal Trade Commission and Department of Justice for certain acquisitions involving parties "engaged in commerce *or in any activity affecting commerce*." (emphasis added).

15. On July 1, 2020, John Elias, a career employee with the Department of Justice's Antitrust Division, testified that the cannabis merger inquiries were not prompted by genuine antitrust concern, but, instead, were motivated by "personal dislike" for the industry. *See* Testimony of John W. Elias, U.S. House Judiciary Committee, Jun. 24, 2020, *available at* https://context-cdn.washingtonpost.com/notes/prod/default/documents/9fda828b-c9ca-4624-a9dc-f744f00fe935/note/f01b9690-59b3-4d98-bbac-9642774df0d3.#page=1.

16. *Id.*

17. Cal. Bus. & Prof. Code § 17500.

18. 17 C.C.R. § 40410.

19. Cal. Civ. Code § 1770(a).

20. *Id.* at §§ 1770(a)(9), (13), (14).

21. *See, e.g.*, *Kwikset Corp. v. Superior Court*, 51 Cal. 4th 310, 321, 324 (2011).

22. Cal. Bus. & Prof. Code § 26052.

23. *Id.* § 26052(a)(4) and (6).

24. Cal. Bus. & Prof. Code § 26052(c) ("Any person or trade association may bring an action to enjoin and restrain any violation of this section for the recovery of damages.").

25. "California's black market for pot is stifling legal sales. Now the governor wants to step up enforcement," *Los Angeles Times*, Feb. 18, 2019, available at https://www.latimes.com/politics/la-pol-ca-gavin-newsom-crackdown-pot-black-market-20190219-story.html (quoting Josh Drayton, a spokesman for the California Cannabis Industry Association).

26. Case No. 2:19-cv-01906 (E.D. Cal. Sept. 18, 2019).

27. The court stayed this case in June 2020 pending the U.S. Food and Drug Administration's release of long-awaited rules regulating the popular hemp-derived compound.

28. Case No. 2:20-cv-03273 (C.D. Cal. Apr. 8, 2020).

29. Case No. 2:19-cv-10227 (C.D. Cal. Dec. 3, 2019).

30. Like *Glass*, this case is now stayed pending federal regulations.

31. 815 ILCS §§ 510 *et. seq.*

32. *See. e.g.*, *Darrow v. Just Brands USA, Inc., et al.*, Case No. 19-cv-07079 (N.D. Ill. Oct. 28, 2019) (class action alleging violations of the ICFDPA because the "JustCBD" brand falsely labeled and advertised their products as containing no THC and in fact contain more than just CBD).

33. § 15-70(p)(5).

34. "State warns some pot shops violated law against stockpiling weed from single source as shortages continue," *Chicago Sun Times*, Jan. 13, 2020, available at https://chicago.suntimes.com/cannabis/2020/1/13/21063993/illinois-legal-weed-shortages-dispensaries-chicago-regulators.

35. C.R.S. § 6-1-105)

36. *Id.*

37. *Crowe v. Tull*, 126 P.3d 196 (Colo. 2006).

38. *See, e.g.*, *Carrick-Harvest, LLC d/b/a Veritas Fine Cannabis v. Veritas Farms, Inc.*, Case No. 20-cv-02017 (D. Colo. Jul. 10, 2020) (alleging common law "trademark infringement, false designation of origin, unfair competition, cybersquatting and declaratory relief arising out of a competitor's bad faith use of nearly identical and confusingly similar trademarks, creating and causing actual confusion in the marketplace.").

39. *Cold Spring Harbor Construction, Inc. v. Cold Spring Builders, Inc.*, 2014 NY slip op. 51688(U).

40. *See, e.g.*, *Gaddis v. Just Brands USA, Inc., et al.*, Case No. 19-cv-62067 (S.D. Fla., Aug. 16, 2019) (class action lawsuit alleging violation of FDUTPA and N.Y. Gen. Bus. Law § 349 because defendants' labeling and packaging repeatedly overstate the quantity of CBD contained in their products).

41. *See, e.g.*, *Gaddis*, *supra*.

42. *See, e.g.*, *Potter v. Potnetwork Holdings, Inc., et al.*, Case No. 19-cv-24017 (S.D. Fla. Sept. 27, 2019) (consumer class action alleging violation of FDUTPA because the actual amount of CBD in the product was less than the amount advertised on the label).

43. Case No. HUD-L-3396-20, (Sup. Ct. N.J. Sept. 22, 2020).

44. A154581, Contra Costa County Super. Ct., Calif., No. MSC1601426.

45. Complaint, *Southshore Restore, et al. v. IL. Dept. of Financial and Professional Regulation*, Case No. 1:20-cv-05264, Sept. 8, 2020 (N.D. IL).

46. "Marijuana Lawsuits Cost Missouri $1.3 Million With No Medical Sales Yet," *The French Toast*, Sept. 14, 2020, available at https://thefreshtoast.com/news/marijuana-lawsuits-cost-missouri-1-3-million-with-no-medical-sales-yet/.